VARIABLE INSURANCE ANNUITY FUND PROGRAM

Related Applications

[0001]   The present application claims the benefit of United States Provisional Patent Application Serial No. 60/414,988, entitled "Variable Insurance Annuity Fund Program," filed October 1, 2002.

Technical Field

[0002]   The present invention relates to variable life insurance products. More particularly, the present invention relates to variable life insurance products designed for capitalizing on potential arbitrage benefits between the life insurance markets and the annuity markets.

Background Of The Invention

[0003]   Over the last decade the insurance industry has developed and popularized variable life insurance products. By design, any investments derived from premium payments toward a variable life insurance product are held in a segregated account of the insurance company and returns inure exclusively to the benefit or detriment of the variable policy holder. Thus, variable life insurance products offer a significant benefit over traditional whole life insurance products, in which any returns on underlying investments are credited to the insurance company at large and the specific policy is credited with a rate of return reflective of the insurance company's overall average return. As another benefit, variable life insurance policy owners are often given a limited ability to select how their policy premiums are invested. For example, variable life insurance policy owners may be allowed to allocate their premiums and policy balances among various investment funds offered by the insurance company.

[0004]   Investment funds used to support variable life insurance products are typically managed by investment advisors selected by the insurance company. The insurance company determines the types and number of available investment funds prior to selling the variable life insurance product to the policy owner. At their inception, fairly basic bond and/or equity funds were used to support most variable life insurance products and policy owners were typically

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given only two or three choices of such funds. However, as the variable life insurance product has matured in the marketplace, the investment options have become far more sophisticated.

[0005] Most types of investments available to the general public have now been replicated as investment options used to support variable life insurance products. In addition, variable life insurance products are now being sold based on the perceived skills and capabilities of the investment advisors managing the policies' investments as much as for their insurance coverage. Thus, at one extreme, some variable life insurance products have evolved from what was initially intended to be a better performing form of life insurance over traditional whole life insurance into a tax efficient vehicle for holding a portion of an individual's investment portfolio. As long as the investments are held inside an individual's variable insurance policy and the policy qualifies as life insurance under the Internal Revenue Code, investment income and capital accumulation inside the policy are not subject to income tax.

[0006] In order to qualify as life insurance under the Internal Revenue Code, an insurance product must provide a minimum death benefit and meet certain diversification requirements. If a variable life insurance policy is not adequately diversified, the policy will not qualify as life insurance under the Internal Revenue Code, and the owner of the policy must recognize ordinary income each year equal to the annual increase in cash value over the premiums paid into the policy for that year. In addition, the Internal Revenue Code requires that the variable life insurance product, not the policyholder, own and control the underlying investments. If the policyholder "controls" the investment of funds in the segregated account, the policyholder will be treated under the Internal Revenue Code as the direct owner of the underlying segregated account assets. Through careful design and constant monitoring of a variable insurance product's compliance with these requirements, insurance companies are able to offer clients variable life insurance products that closely match the client's investment preferences.

[0007] Insurance providers continue to develop innovative variable life insurance products designed to meet the strict requirements imposed by the Internal Revenue Code, while providing clients with investment structures to meet specific client preferences. One such product is known as a private placement policy. A private placement policy is a variable life insurance policy that effectively allows a client to inform the insurance provider of preferred investment funds, including preferred asset classes, preferred management styles and possibly

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even specific preferred fund managers. The insurance company then structures a variable life insurance policy that incorporates as many of the client's preferences as possible or practical. When the variable life insurance policy is written and executed, the resulting premiums are invested consistent with the client's desired investment preferences within the options available under the policy. Again, due to the investor control rules discussed above, investment funds used to support private placement policies may be substantially similar to publicly available funds, but are typically only available through the segregated accounts of the insurance company.

[0008]   Private placement variable life insurance policies have thus allowed policyholders to gain access to certain investment portfolio characteristics inside a tax efficient variable life insurance wrapper. However, prior to the present invention, there remained at least one investment objective that was not successfully adapted to a variable insurance framework. Specifically, variable life insurance products had not been successfully designed to derive the arbitrage benefits that exist between the life insurance markets and the annuity markets. Such "arbitrage," as the term is used herein, refers to the potential yield differential between life insurance products and annuity products, which can result from factors such as prevailing interest rates and different assumptions relied upon by issuers of life insurance and issuers of annuities.

[0009]   The above-mentioned arbitrage opportunity exists in part because an annuity contract and an insurance contract are economic opposites. As a simple illustration, an individual might purchase an annuity contract for $100 and receive a 10% annuity proceed payment of $10 annually during the remainder of his lifetime. As the economic opposite of the annuity arrangement, a life insurance contract might require an individual to pay to the insurance company an insurance premium of $10 annually for the remainder of his lifetime, in order to receive a death benefit equal to the future value of $100 at the individual's actuarially assumed date of death. In this example, if instead of yielding annual annuity proceeds of 10%, the annuity contract yields annual annuity proceeds of 11% and if the death benefit of the life insurance policy is supported by an annual premium of $9 instead of $10, an annual $2 arbitrage opportunity would exist.

[0010]   The competitive nature of the insurance industry may compel a company that specializes in issuing life insurance to offer products that have lower associated premiums than

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those charged by other carriers. The insurance company may rationalize its lower premiums by using different underwriting assumptions than its competitors, such as assumptions concerning higher investment returns or assumptions concerning lower mortality costs and/or administrative costs than those of competitors. Correspondingly, companies specializing in the issuance of annuity contracts frequently quote higher payout rates than other issuers of annuities. Implicit in these rates can be a combination of shorter life expectancy assumptions, higher earnings assumptions and possibly lower administrative and selling costs.

[0011]   The arbitrage between annuity contracts and life insurance contracts can, in some cases, be so significant that it is possible to finance the purchase of the annuity contract and still derive positive spread from the arbitrage. For example, it is possible to borrow funds at an interest rate of about 6% and to invest the loan proceeds in a fixed annuity. The annual annuity proceeds may be sufficient to cover the interest on the loan and the premiums associated with a life insurance policy on the annuitant's life having a death benefit in excess of the loan principal. The excess spread (i.e., the remaining funds after the death benefit is collected and the loan is fully repaid) is net profit to the insured's family. Accordingly, what is needed are new investment products and methods that would allow variable life insurance policies to be created in compliance with the federal income tax requirements, while providing policy owners with opportunities to take advantage of the potential arbitrage between the annuity markets and the life insurance markets.

[0012]   While the debt markets will loan money for the purchase of annuities, the interest rates charge by such lenders typically fluctuate. Conversely, while the yield on annuities can be fixed or variable to only a small degree, there is no guarantee of financial performance by either the annuity carriers or the insurance carriers. As a result, there is a chance that annuity proceeds could be insufficient to repay the loan if interest rates rise or of the annuity carrier(s) or the insurance carrier fails to perform. Therefore, lenders generally require that not only are such loans collateralized by the annuities, but they are also guaranteed by the individual insured or a family member thereof. A general unwillingness by the public to accept such a credit risk must be overcome by any variable life product that is designed to capitalize on the potential arbitrage between the annuity markets and the life insurance markets.

Summary Of The Invention

[0013]   The present invention satisfies the above-described needs by providing variable life insurance products and methods for capitalizing on arbitrage opportunities between annuity markets and life insurance markets. In accordance with certain aspects of the invention, a variable life insurance product is created having a premium obligation that obligates a policyholder to make at least one premium payment to a variable insurance carrier in exchange for variable life insurance on the life of one or more insured. At least a portion of the premium payment is allocated to a segregated account held by the variable insurance carrier for the benefit of the policyholder. The variable life insurance product includes a variable death benefit determined based in part by the value of assets contained within the segregated account upon death of the insured(s). The variable death benefit is payable to at least one beneficiary, which may be an irrevocable trust.

[0014]   At least a portion of the assets in the segregated account comprise one or more leveraged annuity on the life of one or more leveraged annuity client and a beneficial ownership interest in one or more leveraged life insurance policy on the life of one or more leveraged life insurance client. Periodic premium payments on the leveraged life insurance policy or policies are financed by periodic annuity proceeds generated by one or more leveraged annuity. The leveraged annuity or annuities and the leveraged life insurance policy or policies are purchased using loan proceeds from a loan in an amount that is less than a leveraged death benefit of the leveraged life insurance policy.

[0015]   In particular, the assets of the segregated account may comprise shares of an arbitrage fund created by the variable insurance carrier. The arbitrage fund may hold an ownership interest in at least one arbitrage entity. The arbitrage entity, which may be a partnership, a corporation, a trust, a limited liability corporation, a limited liability partnership, or other business entity, may be formed for the purpose of obtaining the loan to purchase the leveraged annuity or annuities and the leveraged life insurance policy or policies. An ownership interest in the arbitrage entity may be offered for sale to the variable insurance carrier, as an asset to be held in the variable life insurance product.

[0016]   The arbitrage entity may itself obtain the loan and purchase the leveraged annuity or annuities and the leveraged life insurance policy or policies. Alternatively, the arbitrage entity may be a beneficiary of an arbitrage trust that owns the leveraged annuity or annuities, the

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leveraged life insurance policy or policies and the loan debt. In some cases, the arbitrage entity may be the sole beneficiary of the arbitrage trust. The arbitrage trust may be, for example, a grantor trust created by the arbitrage entity.

[0017]   Upon death of the leveraged life insurance client(s), the leveraged death benefit is paid to either the arbitrage trust or the arbitrage entity. The leveraged death benefit is used to repay any outstanding balance of the loan, with any remainder of the leveraged death benefit being net arbitrage proceeds. In scenarios involving an arbitrage trust, the arbitrage trust distributes at least a portion of the net arbitrage proceeds to the arbitrage entity as a beneficiary of the arbitrage trust. The arbitrage entity may then liquidate its assets and thereby distribute a portion of the net arbitrage proceeds to the arbitrage fund in accordance with the arbitrage fund's ownership interest in the arbitrage entity.

Brief Description Of The Drawings

[0018]   Figure 1 is an abstract illustration of an exemplary variable life insurance product in accordance with certain exemplary embodiments of the present invention.

[0019]   Figure 2 is a block diagram illustrating certain exemplary investment methods of the present invention.

[0020]   Figure 3 is a block diagram illustrating the flow of funds upon the death of the client or other cause of termination of the insurance products involved in the exemplary investment methods illustrated in Figure 2.

Detailed Description Of Exemplary Embodiments Of The Invention

[0021]   The present invention provides tax efficient investment products and methods for capitalizing on arbitrage opportunities between annuity markets and life insurance markets. In particular, the present invention provides investment methods based on an inventive variable life insurance product that is designed to have a cash value, in the form of death benefits upon death of an insured, based upon potential arbitrage gains between the proceeds of one or more "leveraged annuity" (defined below) on the life of one or more client and the proceeds of one or more "leveraged life insurance policy" (defined below) on the life of one or more client. The inventive variable life insurance product is carefully designed and managed so as to comply with stringent requirements of the Internal Revenue Code, including investor control and

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diversification rules. In addition, the risk inherent in the inventive investment methods are sufficiently minimized such that lenders are more likely to finance the arbitrage transaction without a personal guarantee of the loan by the client(s).

[0022]   For clarity, the term "client" is used herein to generally refer to a person on whose life a leveraged life insurance policy and/or a leveraged annuity is issued. A client may or may not render any payments or receive any direct benefits in connection with the inventive investment products and methods described herein. The term "leveraged life insurance client" is sometimes used to specifically refer to client on whose life a leveraged life insurance policy is issued and the term "leveraged annuity client" is sometimes used to specifically refer to a client on whose life a leveraged annuity is issued. A leveraged life insurance client may or may not be the same person as a leveraged annuity client.

[0023]   The term "insured" is used herein to refer to a person on whose life the inventive variable life insurance policy is issued. A client and an insured may or may not be the same person. In certain embodiments of the invention, an insured, a leveraged life insurance client, and a leveraged annuity client may each be the same individual. In other embodiments, an insured, a leveraged life insurance client, and a leveraged annuity client may each be different individuals.

[0024]   Referring now to the drawings, in which like numerals represent like elements throughout the several figures, exemplary embodiments of the present invention will be described. Fig. 1 illustrates a representative variable life insurance product in accordance with certain exemplary embodiments of the present invention. The inventive variable life insurance product may be, for example, a private placement policy or any other variable life insurance policy **100** that is designed by an insurance company to include the features described herein. The policyholder of the variable life insurance policy **100** may be a client, a family member of a client, an entity owned or controlled by a client or a client's family (e.g., a trust), a charitable organization, or any other person or entity having an insurable interest in the insured. The insured under the variable life insurance policy **100** will typically be one or more client, but could also be one or more other members of a client's family or anyone else in whom the policyholder has an insurable interest. In certain embodiments, the variable life insurance policy could be a survivorship policy.

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[0025]   The variable life insurance policy 100 is managed by an independent fund manager, who allocates fund balances between various investment categories. The insurance company, also referred to as the carrier, creates a fund category (referred to herein as an "arbitrage fund"), which consists of partnerships or other business entities (referred to herein as an "arbitrage entities") that invest to exploit the arbitrage opportunities between the annuity and life insurance markets. The variable life insurance policy 100 includes a premium obligation that obligates the policyholder to make at least one premium payment to the insurance company. At least a portion of the premium payment is allocated to a segregated account held by the insurance company for the benefit of the policyholder.

[0026]   The cash value of the variable life insurance policy 100 is determined based on the value of the assets contained within the segregated account. In order to capitalize on potential arbitrage benefits between the annuity and life insurance markets, the designated fund manager purchases shares of the arbitrage fund established by the insurance company. The arbitrage fund holds an interest in one or more arbitrage entity which directly or indirectly holds one or more annuity and one or more life insurance policy on the life of one or more client. The arbitrage fund shares 105 are then allocated into the segregated account of the variable life insurance policy 100. In certain embodiments, as will be explained below, the arbitrage fund may hold an interest in a single arbitrage entity that holds the one or more annuity and one or more life insurance contract on the life of one or more client. In other embodiments, the segregated account of the variable life insurance policy 100 could include arbitrage fund shares 105 of multiple arbitrage funds.

[0027]   The one or more life insurance policy held by the arbitrage entity is referred to herein as a "leveraged life insurance policy" and the death benefit thereof is referred to herein collectively as a "leveraged death benefit" 115 because the premium payments toward the policy are financed by annuity proceeds from the one or more annuity on the life of one or more client. Similarly, the one or more annuity held by the arbitrage entity is referred to herein as a "leveraged annuity" because its purchase price is preferably financed by a loan. In order to create potential arbitrage opportunities, the loan should be of an amount that is less than the leveraged death benefit 115, but sufficient to purchase both the one or more leveraged annuity and the initial premium(s) on one or more leveraged life insurance policy. Thus, the assets of the segregated account supporting the variable life insurance policy 100 effectively include a

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beneficial ownership interest in the leveraged death benefit **115** and the periodic annuity proceeds **120** of the leveraged annuity.

[0028]   In accordance with certain embodiments of the invention, the leveraged life insurance policy is a whole life policy and the leveraged annuity is a fixed or guaranteed annuity. However, in other embodiments, the leveraged life insurance policy could be a universal life, term or variable policy or any combination thereof and/or the leveraged annuity could be a variable annuity payable for life or for a term of years. In accordance with certain embodiment, the loan used to finance the at least one leveraged annuity and the initial premium on at least one leveraged life insurance policy is a non-recourse loan with a fixed interest rate. In other embodiments, however, the loan could be a recourse loan and/or could have a floating interest rate. The loan could also be dollar denominated or non-dollar denominated.

[0029]   Figure 2 is a block diagram illustrating certain exemplary investment methods of the present invention. In accordance with certain embodiments, the arbitrage entity may be partnership (referred to herein as an "arbitrage partnership" **200**), such as a limited partnership. A limited partnership offers certain advantages with respect to treatment of taxes and liabilities. For example, limited partnerships are not taxable entities. They are "flow through" entities that file tax returns allocating income or loss to the individual partners in any reasonable manner agreed to by the partners. Partners may deduct losses in excess of their actual investment.

[0030]   A limited partnership includes at least one general partner who is the manager and is personally liable for all debts and obligations of the partnership. Limited partners have no liability for partnership obligations, but cannot take part in management of the partnership. In other embodiments, the arbitrage entity may be another type of business entity, such as a general partnership, corporation, trust, limited liability corporation, limited liability partnership, etc. The choice of one of these other types of entities could have different consequences with respect to taxes and liabilities, but may nonetheless be appropriate in certain embodiments.

[0031]   The exemplary arbitrage partnership **200** shown in the Figure 2 has two partners, a general partner **202** and a limited partner **204**. The general partner **202** is intended to hold only a small general partnership interest **203** in the arbitrage partnership **200** (for example, 0.5%), but maintain control over the investments of the arbitrage partnership **200**. The limited partnership interest **205** held by the limited partner **204** is intended to be the majority interest in the arbitrage partnership **200** (for example, 99.5%). In other embodiments, the arbitrage partnership **200** may

have multiple limited partners **204** and/or multiple general partners **203**. Other ownership structures may be employed depending on such things as the nature of the arbitrage entity and the laws under which the arbitrage entity is formed.

[0032]   The arbitrage partnership **200** is organized in a manner that allows it to have an insurable interest in the one or more client. For example, the arbitrage partnership **200** may create an insurable interest in a client by naming the client as director **201** of the arbitrage partnership **200**. As another example, the arbitrage partnership **200** may include an independent advisory board, of which one or more client may be a member. There are many other ways to ensure that the arbitrage partnership **200** has an insurable interest in a client and the exact approach will vary depending on the applicable state laws governing insurable interests.

[0033]   The arbitrage partnership **200** may itself invest in the potential arbitrage between the annuity and life insurance markets or may form a subsidiary or other related entity to make such arbitrage investments. The exemplary embodiment illustrated in Figure 2 contemplates the use of a revocable trust (referred to herein as an "arbitrage trust" **206**) in order to make such arbitrage investments. An arbitrage trust **206** may be structured to serve as a bankruptcy remote entity that insulates the arbitrage investment assets from a potential bankruptcy situation of the arbitrage partnership **200**. Thus, the arbitrage trust **206** may be perceived as reducing the risk borne by the lender that finances the arbitrage transactions. Other benefits, such as potential tax benefits, of an arbitrage trust **206** will be apparent to those of skill in the art. Although the use of an arbitrage trust **206** is preferred in certain embodiments, the present invention is not intended to be so limited.

[0034]   In the example of Figure 2, the arbitrage trust **206** initiates its arbitrage investments by taking out a loan from an unrelated financial institution **208**, such as a bank or other lender. The arbitrage trust **206** may acquire the loan from a financial institution **208** that offers the most attractive terms. One or more loan may be obtained by the arbitrage trust **206**. Again, the loan (or loans) may be on a non-recourse or recourse basis, depending on risk tolerance and other market factors. The loan principal **212** is received by the arbitrage trust **206** and the resulting loan debt **210**, i.e., obligation to make periodic (e.g., annual) principal and interest payments **214**, becomes a liability of the arbitrage trust **206**.

[0035]   A portion of the loan proceeds (loan principal **212** less after any applicable fees, charges or other expenses deducted therefrom) is then used to acquire one or more leveraged

annuity 216 on the life of one or more annuity client from an annuity insurance company 218, also referred to as an annuity carrier. The selection of the annuity insurance company 218 may be based upon a number of factors, including the nature of the loan (recourse, non recourse, etc.) obtained by the arbitrage trust 206, risk tolerance, quoted annuity proceeds 120 and annuity purchase prices 220. In addition, a portion of the loan proceeds are used by the arbitrage trust 206 to acquire one or more leveraged life insurance policy 222 on the life of one or more leveraged life insurance client, of which the arbitrage trust 206 will be the owner and beneficiary.

[0036] The one or more leverage life insurance policy 222 could be whole, universal, variable or any other kind of permanent life insurance. Term insurance may also be acquired in certain embodiments. The one or more leverage life insurance policy 222 may be purchased from one or more insurance company 224. The arbitrage trust 206 will preferably purchase as much life insurance on the life of the leveraged life insurance client(s) as the cash flow from the one or more leveraged annuity 216 will sustain. In certain exemplary embodiments, the one or more leveraged life insurance policy 222 is preferably a guaranteed contract, which will pay a specified death benefit regardless of the economic performance of the contract's underlying investments or the economic performance of the insurance company 224, provided that premium payments 226 are made on a timely basis.

[0037] The one or more leveraged annuity 216 is preferably a fixed annuity contract, because the periodic (e.g., annual) annuity proceeds 120 are a sum certain. However, depending on the risk tolerance of the arbitrage trust 206, the one or more leveraged annuity 216 may be a variable annuity or a combination of fixed and variable annuities. In certain embodiments, the loan proceeds are used to purchase five or more leveraged annuities 216 on the life of one or more leveraged annuity client, issued by one or more annuity companies 218, so as to ensure that the assets of the arbitrage trust 206 satisfy the diversification requirements of the Internal Revenue Code. In other embodiments, such diversification requirements could be satisfied through the purchase of multiple leveraged annuities 216 and multiple leveraged life insurance policies 222 on the life one or more client.

[0038] The arbitrage trust 206 will use the periodic annuity proceeds 120 from the one or more leveraged annuity 216 to pay the premium payments 226 of the one or more leveraged life insurance policy 222 and to make principal and/or interest payments 214 on the bank loan. In

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certain embodiments, the arbitrage trust may make interest-only payments 214 against the loan, until the death benefit of the one or more leveraged life insurance policy 222 is received. The loan may be secured by the one or more leveraged annuity 216 and by the one or more leveraged life insurance policy 222. As should now be apparent, arbitrage opportunities exist where the loan can be used to finance the purchase of the one or more leveraged annuity 216 and the one or more leveraged life insurance policy 222, where the annuity proceeds 120 can be used to finance the premium payments 226 of the one or more leveraged life insurance policy 222 and at least the interest payments 214 on the loan, and where the death benefit of the one or more leveraged life insurance policy 222 exceeds the outstanding balance of the loan.

[0039] The above-described arbitrage investments of the arbitrage entity are used to support the variable life insurance policy 100 of the present invention. As described above, a variable life insurance carrier 230, which may be the same or a different carrier than the life insurance company (or companies) that issued the one or more leverage life insurance policy 222, may issue the variable life insurance policy 100 on the life of one or more insured. Again the insured may be a client and/or a family member of a client and/or anyone else in whom the policyholder has an insurable interest. Similarly, the policyholder may be a client, a family member of the client, an entity owned or controlled by a client and/or a client's family, a charitable organization or any other person or entity that has an insurable interest in the insured under the variable life insurance policy 100. In the example shown in Figure 2, the policyholder is an irrevocable trust 232, which may be a family trust, a charitable trust, etc.

[0040] At least one variable life insurance premium payment 234 is made to the variable insurance carrier 230 in exchange for the variable life insurance policy 100. In certain embodiments, the variable life insurance premium payment 234 consists of a single premium payment. Any variable life insurance premium payment 234 is allocated to the segregated account 236 of the variable insurance carrier 230. The manager of the segregated account 236 uses the funds therein to purchase the limited partnership interest 205 of the arbitrage partnership 200 from the limited partner 204.

[0041] Again, in certain exemplary embodiments, the limited partnership interest 205 represents approximately a 99.5% interest in the arbitrage partnership 200. The purchase price 240 of the limited partnership interest 205 may be any negotiated amount, but is preferably an amount not exceeding the variable life insurance premium payment 234 paid into the segregated

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account **236**. In any event, the purchase price **240** should correspond to the estimated fair market value of the limited partnership interest **205**, as supported by an independent appraisal from a reputable valuation firm. The variable life insurance premium payments **234** may be paid by the irrevocable trust **232** using funds gifted to it by its grantor **242** (shown in Figure 2 as the cash gift **244**).

[0042]   Those familiar with the legalities of trusts will appreciate that many different types of trusts, both revocable and irrevocable, may be used to own a variable life insurance policy **100** and receive its resulting death benefits, depending on the intended purposes of the trust. For example, the contemplated irrevocable trust **232** would be used to separate the death benefit of the variable life insurance policy **100** from the estate of any individual, thus avoiding the imposition of estate taxes on the insurance proceeds in the individual's taxable estate. In certain exemplary embodiments, the intended purposes of the irrevocable trust **232** may also include shielding the grantor **242**, trustee **246** and beneficiaries **248** from any liabilities incurred by the irrevocable trust **232**, including actual or potential income tax liabilities. Thus, the irrevocable trust **232** may need to be carefully designed and managed in accordance with accepted practices in order to accomplish these or any other intended purposes.

[0043]   Figure 3 is a block diagram illustrating the flow of funds upon the death of the one or more leveraged life insurance client (and/or insured), or other cause of termination of the one or more leveraged life insurance policy **222**, the one or more leveraged annuity **216** and the variable life insurance policy **100** involved in the exemplary investment methods illustrated in and described with respect to Figure 2. Upon such occurrence or occurrences, the arbitrage trust **206** will cease to receive the leveraged annuity proceeds **120**, but will collect the death benefit of the one or more leveraged insurance life policy **222** (referred to collectively herein as the "leveraged death benefit" **302**.) The arbitrage trust **206** will then make a payment to the financial institution **208** in the amount of the outstanding balance **304** of the loan (i.e., the loan principal plus any unpaid accrued interest.) Any net proceeds that remain after repayment of the loan are referred to herein as net arbitrage proceeds **306**.

[0044]   The arbitrage trust **206** distributes any net arbitrage proceeds **306** to the arbitrage partnership **200**. The arbitrage partnership **206**, in turn, distributes the net arbitrage proceeds **306** to its partners. For example, the arbitrage partnership may liquidate its assets in order to make a distribution thereof to its partners. Accordingly, in the example shown in Figure 2 and Figure 3,

the general partner **202** receives a general partner share **308** (equal to the general partnership interest **203**, e.g., 0.5%) of the net arbitrage proceeds **306** and the segregated account **236** associated with the variable life insurance policy **100** will receive a limited partner share **310** (equal to the limited partnership interest **205** e.g., 99.5%) of the net arbitrage proceeds **306**. The death benefit of the variable life insurance policy **100** (referred to herein as the "variable death benefit" **312**) thus includes the limited partner share **310** of the net arbitrage proceeds **306**. The variable death benefit **312** is distributed by the variable insurance carrier **230** to the irrevocable trust **232** and/or other beneficiary of the variable life insurance policy **100**.

[0045]   Once an asset of the irrevocable trust **232**, the variable death benefit **312** should not subject to income taxation or estate taxation. The trustee **246** manages the assets of the irrevocable trust **232** in accordance with the trust instrument. If authorized the do so, the trustee **246** may purchase assets of or make loans to the estate of a client (or an insured) in order to cover estate taxes and/or other expenses. Thus, certain embodiments of the present invention can provide, among other benefits, liquidity to meet future estate tax burdens. The invention can also make permanent life insurance coverage an option for families who might not otherwise be able to afford such protection.

[0046]   In order to maximize the net arbitrage proceeds **306** and thus the variable death benefit **312** available to the beneficiary of the variable life insurance policy **100**, the optimum amounts of the loan, the one or more leveraged annuity **216** and the one or more leveraged life insurance policy **222** that must be obtained by the arbitrage entity need to be determined. As stated above, the general goal of the arbitrage entity should normally be to purchase as much life insurance as the annual cash flow from the one or more leveraged annuity **216** will permit. However, the annual cash flow generated by the one or more leveraged annuity **216** is dictated by the amount of the loan obtained to purchase the leveraged annuity **216**. Thus, optimization of the exemplary arbitrage transactions involves solving two simultaneous equations involving three inter-dependent variables: the amount of loan, the purchase price of the leveraged annuity **216**, and the amount of periodic (e.g., annual) premium payment **226** for leveraged life insurance policy **222**.

[0047]   In accordance with certain exemplary embodiments, the two simultaneous optimization equations are as follows:

(i) $A = L - F - O - P$; and

(ii) $A * X = (R * L) + C + P,$

where 'A' represents the purchase price of the one or more leveraged annuity **216**; 'L' represents the gross loan amount obtained from the lender; 'F' represents any loan finance charge (usually expressed as a percentage of the gross loan amount) that may be charged by the lender; 'O' represents the sum of all one time costs of establishing the exemplary arbitrage transactions that are payable out of the loan proceeds; 'X' represents the applicable annuity payment rate quoted by the annuity carrier for the client; 'R' represents the annual interest rate on the loan; 'C' represents the sum of all annual costs or other reserves to be funded out of the annuity proceeds; and 'P' represents the annual premium payment **226** for the one or more leveraged life insurance policy **222**.

[0048]   Thus, the amount of money available to purchase the one or more leveraged annuity **216** is equal the net loan proceeds (i.e., gross loan proceeds minus any applicable finance charge) less the initial life insurance premium **226** less any other costs required for establishing the exemplary arbitrage transactions. Any such other costs required for establishing the exemplary arbitrage transactions will be known in advance and are effectively constant. Simultaneously, the annual annuity payment rate (a factor also known in advance) is multiplied by the amount of the one or more leveraged annuity **216** to determine the annual annuity proceeds **120**. The amount of money available to be used as an annual premium payment **226** for the one or more leveraged life insurance policy **222** equals the annual annuity proceeds **120** less annual loan interest expense (i.e., the gross loan amount multiplied by the applicable interest rate) and any less annual fixed costs and reserves. Once the amount of the annual premium payment **226** is calculated, the quotes for the cost of the one or more leveraged life insurance policy **222** will permit the calculation of the leveraged death benefit **302**.

[0049]   In most cases, at least one of the three inter-related variables ('L,' 'A' and 'P') is constrained. For example, the maximum gross loan amount may be dictated by the available lenders. Also, in some circumstances, there may be a limited amount of leveraged life insurance coverage or a limitation on the amount of the annuity contracts available to a client. When one or more inter-related variable is constrained, it is treated as a constant and the above optimization equations are solved for the remaining variables.

[0050]   Based on the foregoing, it can be seen that the present invention provides tax efficient investment products and methods for capitalizing on the potential arbitrage

opportunities that exist between the annuity and life insurance markets. Many other modifications, features and embodiments of the present invention will become evident to those of skill in the art. It should also be appreciated, therefore, that many aspects of the present invention were described above by way of example only and are not intended as required or essential elements of the invention unless explicitly stated otherwise. Accordingly, it should be understood that the foregoing relates only to certain embodiments of the invention and that numerous changes may be made therein without departing from the spirit and scope of the invention as defined by the following claims.